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RUEHKSO/AMCONSUL SAPPORO 5597  
RUEHFK/AMCONSUL FUKUOKA 4949  
RUEHOK/AMCONSUL OSAKA KOBE 8615  
RUEHNH/AMCONSUL NAHA 7345  
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TAGS: [ECON](#) [PGOV](#) [EFIN](#) [JA](#)  
SUBJECT: JAPAN: ECONOMIC POLICY UNDER A DIVIDED DIET

REF: A. 06 TOKYO 5962

[1](#)B. TOKYO 5378

#### Summary

[1](#)1. (SBU) The ruling Liberal Democratic Party's loss in July 2007's Upper House election resulted in a divided Diet and legislative gridlock, which has undercut economic reform advocates and pushed economic policymaking away from the prime minister's office. The result is a tougher environment for regulatory reform. End Summary.

#### Stuck in Traffic

[1](#)2. (SBU) Following the opposition Democratic Party of Japan's (DPJ's) unprecedented victory in July's Upper House election, Japan's divided Diet has been gridlocked. For the first time in more than forty years, it took more than 60 days for the Diet to pass its first legislation, a minor law on disaster relief.

[1](#)3. (SBU) Media have focused on the DPJ's opposition to Japan's Indian Ocean refueling operation, but polls rank domestic pocketbook issues at the top of Japanese voters' concerns. Pension reform, for example, outscored foreign policy ten-to-one as voters' primary issue in a recent survey.

[1](#)4. (SBU) Nonetheless, there is little prospect for legislative movement on substantive economic issues. Diet members from both the ruling Liberal Democratic Party (LDP) and opposition DPJ have told the Embassy they expect no substantial progress on "politicized" issues -- including pension reform, improvements to the healthcare system, and

tax policy -- until the current political situation changes, whether through a general election, party reorganization, or new electoral coalition.

15. (SBU) Some Diet members have suggested limited cooperation is possible between the LDP and DPJ on "non-political" topics, such as measures to increase Tokyo's competitiveness as an international financial center and aviation deregulation, and the Diet did revise the Minimum Wage Law on November 28. But other economic legislation enacted this session has either been non-controversial or -- in the case of a new law on labor contracts -- was stripped of content as it moved through consultative committees at the Ministry of Health, Labor, and Welfare.

16. (SBU) Moreover, DPJ Diet members are lining up issues on which to confront the LDP, likely pushing back the timeline for normal Diet business well into 2008. DPJ back-benchers have told Emboffs they plan to contest the confirmation of the next Bank of Japan Governor (the current governor's term ends in March), as well as tax measures linked to the budget. Add the budget debate itself, which is the usual centerpiece of the spring Diet session, and there appears to be little room for routine business prior to the G8 summit in July 2008.

Location, Location, Location  
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17. (SBU) In the meantime, with the possibility of a snap election sometime in 2008, Diet members are positioning themselves on hot-button issues -- with one of the hottest being the question of regional disparities. Perceptions of a widening economic gap between Japan's urban and rural areas became a major theme in July's election, when large numbers

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of voters in the LDP's traditional rural strongholds abandoned the party. Many Diet members have blamed the loss on the structural economic reforms former PM Koizumi initiated. The backlash against Koizumi reforms has strengthened pro-rural, pro-agricultural, and anti-reform currents within the LDP.

18. (SBU) Unsurprisingly, both the DPJ and LDP are discussing agricultural support policies, setting off fears (not as yet materialized) that fiscal policies will be loosened as the parties move into election mode. The anxieties about regional disparities run far deeper, however. In discussing tax policy, for example, one Diet member carefully explained to the Embassy the relative political merits and demerits of changing the consumption, corporate, and income taxes, based on how each would shift burdens and benefits between urban and rural voters.

Urban-Rural Divide: Not empty issue  
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19. (SBU) Japan's growing urban-rural divide and income gaps reflect profound demographic and social changes in Japanese society. While some try to milk the issues for political advantage, responding to the challenges of a growing divide between city and country and widening income disparity engages all politicians from the left and the right. All perceive that Japan, where once almost 90% of citizens self-identified as "middle class," has emerging upper and lower classes based on income. The sense of crisis deepened when the OECD published a July 2006 report that found Japan's income inequality had risen above the OECD average (ref A).

Who's Driving?  
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110. (SBU) Economic policymaking has shifted as well under the divided Diet. The Council on Economic and Fiscal Policy (CEFP) and Council for the Promotion of Regulatory Reform (CPRR), weakened during the Abe administration, are no longer the central venue for economic policymaking. Prime Minister Fukuda instead relies on the bureaucracy and a group of party officials, including LDP Policy Research Council Chair

Sadakazu Tanigaki, Tax Policy Chief Kaoru Yosano, and party heavyweight Hideano Nakagawa, to hash out policies. As one private sector member of the CEFPP told the media, "Abe was close to the party, which restricted the CEFPP's freedom, but under the divided Diet we have no freedom at all."

Comment

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¶11. (SBU) By both stalling economic legislation and shifting the locus of policymaking, Japan's divided Diet has made the environment tougher for regulatory reform. The CEFPP and CPRR, natural advocates for reforming Japan's economy, have been weakened. The rise of regional disparities as an electoral issue has made reform more difficult politically, and the shift back toward the bureaucracy and party heavyweights in policymaking has made the process less transparent. As bilateral reform discussions proceed, it is likely that more and more bureaucrats will invoke gridlock as an excuse, arguing that needed steps "cannot be done given the Diet situation."

SCHIEFFER